

Audit Report



NAVY FY 1999 FINANCIAL REPORTING OF OPERATING
MATERIALS AND SUPPLIES - AMMUNITION

Report No. D-2000-183

September 1, 2000

Office of the Inspector General
Department of Defense

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Acronyms

CAIMS	Conventional Ammunition Integrated Management System
CFO	Chief Financial Officers
DON	Department of the Navy
JAMSS	Joint Ammunition Management Standard System
LAC	Latest Acquisition Cost
NALC	Naval Ammunition Logistics Center
OM&S	Operating Materials and Supplies
SFFAS	Statement of Federal Financial Accounting Standards



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**

September 1, 2000

**MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
AND CHIEF FINANCIAL OFFICER
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
COMMANDER, NAVAL AMMUNITION LOGISTICS
CENTER, NAVAL SUPPLY SYSTEMS COMMAND**

**SUBJECT: Audit Report on Navy FY 1999 Financial Reporting of Operating
Materials and Supplies - Ammunition (Report No. D-2000-183)**

We are providing this final report for your information and use. This is the second in a series of reports on the DoD financial reporting of ammunition as part of Operating Materials and Supplies.

We considered management comments on a draft of this report when preparing the final report. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) comments conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. James L. Kornides at (614) 751-1400, extension 11, e-mail jkornides@dodig.osd.mil, or Mr. John K. Issel at (614) 751-1400, extension 12, e-mail jissel@dodig.osd.mil. See Appendix C for the report distribution. The audit team members are listed on the inside back cover.

A handwritten signature in black ink, reading "Robert J. Lieberman", is positioned above the typed name.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. D-2000-183

(Project No. D2000FJ-0069.002)

September 1, 2000

Navy FY 1999 Financial Reporting of Operating Materials and Supplies - Ammunition

Executive Summary

Introduction. DoD defines Operating Materials and Supplies as tangible personal property that is to be consumed in normal operations. This report discusses the Navy's reporting of conventional ammunition, which is a part of the Navy Operating Materials and Supplies. A previous report discussed the reporting of Army ammunition.

In general, Navy conventional ammunition consists of any non-nuclear item charged with explosives, excluding missiles and torpedoes, which are reported as Required Supplementary Stewardship Information. The total conventional ammunition accounted for in the FY 1999 Navy financial statements was \$10.5 billion, or 35.8 percent of the \$29.3 billion the Navy reported for Operating Materials and Supplies. Navy ammunition represented 28 percent of the \$36.7 billion of conventional ammunition reported in the FY 1999 DoD Agency-wide Financial Statements.

Objectives. The overall objective of our audit was to obtain information on the financial reporting of Operating Materials and Supplies and the appropriateness of policies and regulations governing accounting for Operating Materials and Supplies. We focused this part of the audit on reporting of conventional ammunition in the FY 1999 Navy financial statements. As part of the audit, we were to assess the internal control structure as it pertained to Operating Materials and Supplies. We did not assess the internal control structure because the Navy reported in its FY 1999 financial statements that it lacked the systems and procedures to adequately report Operating Materials and Supplies, including conventional ammunition.

Results. In reporting ammunition in Operating Materials and Supplies on the financial statements, the Navy was unable to implement all elements of Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property, Net," October 27, 1993, because of the limitations of its financial management processes and systems, including nonfinancial feeder systems. The Navy reported an ammunition balance of \$10.5 billion, but disclaimed the appropriateness of that balance. Navy managers stated that they had been making process and system improvements and addressing the limitations of its financial and nonfinancial feeder systems. However, the system limitations were significant reporting issues that

remained unresolved for the FY 1999 financial statements. The Navy was waiting for a new DoD ammunition accounting system to correct deficiencies, but the continued development of the new system is currently in question and may not be fielded by FY 2001. As a result, the balance reported for ammunition in the Operating Materials and Supplies account of the FY 1999 Navy General Fund Balance Sheet could not be confirmed and will not be for several years.

Recommendation. We recommend that the Commander, Naval Ammunition Logistics Center, Naval Supply Systems Command, determine the costs and benefits of making system design changes to the Conventional Ammunition Integrated Management System to value Navy ammunition at historical cost. Specifically, the Navy should determine the practicality of system design changes by reviewing short and long-term benefits to be gained while awaiting the pending development of the Joint Ammunition Management Standard System, costs to be incurred, approved cost flow assumptions, and changes required to feeder systems.

Management Comments. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) concurred with the report and recommendation. He stated that the Naval Ammunition Logistics Center has begun the analysis and cost benefit identification of making the Conventional Ammunition Integrated Management System compliant with federal accounting standards. System changes will be implemented after clarification of the policy conflict between the DoD Financial Management Regulation and the DoD Material Management Regulation. Evaluation is currently underway to draft the appropriate business rules for meeting the cost flow assumptions of the Statement of Federal Financial Accounting Standards No. 3. Costs to achieve Chief Financial Officer Act compliance have been estimated at \$300,000.

Audit Response. Management comments were responsive, and no further comments are required. A discussion of management comments is in the Finding section of the report, and the complete text of the comments is in the Management Comments section.

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Background

Introduction. The audit was performed in support of Public Law 101-576, the "Chief Financial Officers [CFO] Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. This is the second of three reports resulting from our audit of DoD financial reporting of ammunition as part of Operating Materials and Supplies (OM&S). The first report discussed the reporting of Army ammunition. This report discusses the Navy's reporting of ammunition. We will not issue an Air Force report, as they have identified the problems and corrective actions are ongoing. The third report discusses the development and implementation of a joint ammunition system.

The Naval Audit Service assisted with the audit work. Naval Audit Service Draft Report No. 1999-0149, "Department of the Navy Principal Statements for FY 1999: Inventory and Related Property, Net," February 25, 2000, concluded that controls in the systems tested were not adequate for financial reporting purposes.

Navy Ammunition Financial Reporting

Operating Materials and Supplies. The Navy reports OM&S in the Inventory and Related Property, Net line item of its Consolidated Balance Sheet on both the General Fund and Working Capital Fund financial statements. Ammunition is included in the OM&S reported on the General Fund financial statements only. The following table shows the categories of OM&S reported in the FY 1999 Navy General Fund financial statements.

Classes of OM&S Reported by Navy (dollars in thousands)	
<u>Type of OM&S</u>	<u>Value</u>
Held for Use	\$27,881,826
Held in Reserve for Future Use	788,762
Excess, Unserviceable, and Obsolete	607,156
Total	\$29,277,744

As shown above, OM&S for FY 1999 was valued at \$29.3 billion. Total ammunition accounted for in the FY 1999 financial statements was \$10.5 billion, or 35.8 percent of the total OM&S reported.

Navy Definitions. The Navy categorizes ammunition as nuclear or conventional. This report addresses conventional ammunition only. Conventional ammunition is defined as any item charged with explosives, propellants, pyrotechnics, or chemical material for defense or offense, including demolition. An item of ammunition can range from a precision guided missile to a shotgun shell. As discussed above, conventional ammunition represents a

significant portion of the OM&S reported by the Navy each year in its financial statements.

Navy Process and Ammunition System. The Navy warehouses ammunition at storage depots and installations and on ships until the items are issued. The Naval Ammunition Logistics Center (NALC) is the ammunition inventory manager for the Navy and uses the Conventional Ammunition Integrated Management System (CAIMS) to monitor the amount and location of ammunition. This logistics system gives the NALC a central repository for information on Navy ammunition worldwide. CAIMS interfaces with several systems to share information related to the management of conventional ammunition.

Objectives

The overall objective of our audit was to obtain information on the financial reporting of OM&S and the appropriateness of policies and regulations governing accounting for OM&S. We focused this part of the audit on the reporting of conventional ammunition in the FY 1999 Navy financial statements. As part of the audit, we were to assess the internal control structure as it pertained to OM&S. We did not assess the internal control structure because the Navy reported in its FY 1999 financial statements that it lacked the systems and procedures to adequately report OM&S, including conventional ammunition. This audit was originally announced under Project No. OFJ-2103.

FY 1999 Financial Reporting of Navy Ammunition

In reporting ammunition in OM&S on its financial statements, the Navy was unable to implement all elements of Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property, Net," October 27, 1993, because of the limitations of its financial management processes and systems, including nonfinancial feeder systems. The Navy reported an ammunition balance of \$10.5 billion, but disclaimed the appropriateness of the balance. Navy managers stated that they had been making process and system improvements and addressing the limitations of the Navy's financial and nonfinancial feeder systems. However, the system limitations were significant reporting issues that remained unresolved for the FY 1999 financial statements. The Navy was waiting for a new DoD ammunition accounting system to correct deficiencies, but the new system is currently in question and may not be fielded. As a result, the balance reported for ammunition in the Operating Materials and Supplies account of the FY 1999 Navy General Fund Balance Sheet could not be confirmed and will not be for several years.

Reporting and Disclosure of Ammunition

The FY 1999 Navy financial statements reported \$10.5 billion under OM&S for conventional ammunition, but also disclosed that the data contained material financial reporting limitations. In Footnote 1 A, "Significant Accounting Policies: Basis of Presentation," the Department of the Navy (DON) reported that it

... is unable to implement all elements of the Statement of Federal Financial Accounting Standards (SFFAS) due to limitations of its financial management processes and systems, including nonfinancial feeder systems and processes. Reported values and information for the DON's major asset and liability categories are derived from nonfinancial feeder systems, such as inventory systems and logistics systems. These systems were designed to support reporting requirements focusing on maintaining accountability over assets and reporting the status of federal appropriations, and not the current emphasis of business-like financial management reporting. As a result, the DON can not currently implement all elements of SFFAS. However, the DON continues to implement process and system improvements addressing the limitations of its financial and nonfinancial feeder systems.

In Footnote 1 K, "Inventories and Related Property," which addresses OM&S, the Navy reflected material limitations on the reporting of OM&S. OM&S was valued at latest acquisition cost (LAC). LAC was used because

. . . data is maintained in logistics systems designed for material management purposes. These legacy systems do not maintain the historical cost data necessary to comply with SFFAS No. 3, "Accounting for Inventory and Related Property." While these legacy systems provide controls to ensure accountability and visibility over inventory items, they were not designed to ensure that all of the inventory items are included in the values reported on the Balance Sheet.

Additionally, under Footnote 8 B, "Operating Materials and Supplies (OM&S), Net," the Navy stated the following:

The consumption method of accounting for the recognition of expenses has been applied to OM&S. However, current financial and logistics systems can not fully support the consumption method.

Navy Actions to Improve Ammunition Reporting

OM&S Working Groups. In August 1999, the Navy established a working group that addressed OM&S accounting and reporting problems. By October 1999, the working group had defined Navy conventional ammunition as any complete device charged with explosives, propellants, pyrotechnics, initiating composition, or nuclear, biological, or chemical material for use in military operations, including demolition. The working group also defined an end user as any entity that obtains goods for direct use in that entity's normal operations. Standard definitions were needed to achieve consistency. Additionally, at the time of our audit, the working group was developing a plan to consolidate the systems used to capture and report Navy OM&S.

Additional Navy Initiatives. The Navy was working to expand use of the consumption method of accounting for OM&S, to include ammunition. In Footnote 8 B, the Navy discussed planned improvements in the financial reporting of its OM&S, including ammunition. The Navy said that DoD

. . . has reached an agreement with Office of Management and Budget, General Accounting Office, and the Inspector General, DoD to move to the consumption method of accounting for OM&S in future years. Based on this agreement, the DoD will:

1. develop a framework for conducting cost-benefit analysis for use in determining whether the consumption method is cost beneficial for selected instances of OM&S;
2. work with its auditors in developing specific criteria for determining when OM&S amounts are not significant for the purpose of using the consumption method;
3. develop functional requirements for feeder systems to support the consumption method;

-
4. and identify feeder systems that are used to manage OM&S items and develop plans to revise those systems to support the consumption method.

Navy Ammunition System and CFO Act

Although the Navy has taken several actions to improve ammunition financial reporting, the system used by the Navy to report ammunition financial data is not compliant with the reporting requirements of the CFO Act. For a system to be in compliance with the CFO Act, it must meet the requirements described in Public Law 104-208, the "Federal Financial Management Improvement Act of 1996," September 30, 1996; Office of Management and Budget Circular No. A-127, "Financial Management Systems," July 23, 1993; and a series of Federal financial management system requirements published by the Joint Financial Management Improvement Program.

The biggest problem for the Navy was that its ammunition system did not capture the historic cost of the ammunition it owned. SFFAS No. 3, "Accounting for Inventory and Related Property, Net," October 27, 1993, requires that OM&S be valued on the basis of historical cost. Historical cost includes all appropriate purchase and production costs incurred to bring the items to their current condition and location. To arrive at historical cost, SFFAS No. 3 states that the first in-first out, weighted average, or moving average cost flow assumptions shall be applied. It also states that any other valuation method may be used if the results reasonably approximate those of a historical cost method. The Navy's ammunition management system, CAIMS, was not designed to capture or maintain the historical cost of ammunition. CAIMS, the central repository for information on Navy ammunition, replaces the original estimated unit price with the current unit price or LAC after each purchase is made.

Although CAIMS is not currently compliant with Federal financial requirements, the Navy has taken action to significantly improve its system. The changes include taking the system from a mainframe database structure with little flexibility, to an open system environment or relational environment. The purpose of this improvement was to lower the overall annual maintenance cost of the system and to provide users with greater functionality and capabilities to manage ammunition data. The initial change to an open system environment will be completed by October 2000. The Navy spent \$2.2 million between FY 1997 and FY 1999 to upgrade CAIMS and plans to spend an additional \$640,000 during FY 2000.

NALC management is confident that CAIMS, under the new open system environment, could be changed to properly record and/or calculate the historical cost of ammunition. NALC management estimated that once a standard business practice of valuing ammunition was established, they would need approximately eight weeks to restructure CAIMS to compute the historical cost as required by SFFAS No. 3.

Joint Ammunition System

Navy management has not redesigned CAIMS to capture or compute the historical cost because a standardized DoD-wide ammunition system, the Joint Ammunition Management Standard System (JAMSS), was being developed to improve the financial reporting of ammunition inventory. The intent of developing one standardized system was to improve the consistency of business operations and processes of the Services, which each use different information systems to manage their ammunition inventories.

Recent developments, however, indicate that the development of the new system is currently in question and may not be fielded at all. During the past four months, the initial release date of JAMSS has slipped from November 2001 to January 2003. Additionally, the contractor was unable to meet scheduled milestones putting the continued development of JAMSS in question. In March 2000, the JAMSS contract was placed on a 60 day suspension. During that time, the executive program office required that an assessment be done to re-validate the requirements of the services and subgroups. There is concern that the new system will not provide the functionality and capabilities necessary for DoD to effectively manage its ammunition. The executive program office also required that the assessment identify alternatives to the new system if the suspension concludes with terminating the contract.

We will continue our review of the financial reporting of OM&S, specifically focusing on JAMSS and the problems that hinder its development, and will report accordingly. In the meantime, Navy management should determine the specific costs and practicality of modifying CAIMS to compute and maintain the historical cost of ammunition. The Navy must determine the costs of the changes required to ensure that CAIMS can capture the historic costs of ammunition. Changes to the desired cost flow assumptions must also be evaluated to determine whether the first in-first out, weighted average, moving average, or other methods that approximate historic costs can be used, and which is most advantageous. Also, changes to the feeder systems used to manage ammunition must be weighed, as well as short-term benefits derived while awaiting the possibility of JAMSS conversion and long-term gains if JAMSS is not implemented.

In the past, the development of new systems has taken more time than expected. Considering the instability of the JAMSS development, we believe that the Navy should determine whether it is practical and cost-beneficial to alter CAIMS to capture the historical cost of its ammunition. Until a system change occurs or a new system is fielded, the Navy will be unable to capture the historical cost of \$10.5 billion of ammunition, and the result will be noncompliance with SFFAS and unauditable amounts of ammunition in the Navy OM&S account.

Recommendation and Management Comments

We recommend that the Commander, Naval Ammunition Logistics Center, Naval Supply Systems Command, determine the costs and benefits of making system design changes to the Conventional Ammunition Integrated Management System to properly value Navy ammunition at historical cost. The Navy should determine the practicality of system design changes by:

1. Reviewing short-term benefits to be gained while awaiting the possible development of the Joint Ammunition Management Standard System, and long-term benefits if the Joint Ammunitions Management Systems Standard is not fielded;

Management Comment. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) concurred and stated that the Commanding Officer, Naval Ammunition Logistics Center, completed the benefit analysis of correcting CAIMS versus awaiting the deployment of JAMSS. System changes to CAIMS will be implemented after clarification of the policy conflict between the DoD Financial Management Regulation (DoD 7000.14-R) and the DoD Material Management Regulation (DoD 4140.1-R) concerning valuation requirements.

2. Reviewing costs to be incurred;

Management Comment. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) concurred and stated that the Commanding Officer, Naval Ammunition Logistics Center, is currently developing a Statement of Work to accomplish the third party evaluation required by the Department of the Navy. This third party evaluation is estimated to cost \$250,000.00. An internal analysis of CAIMS established a total cost of \$300,000.00 to make CAIMS compliant.

3. Reviewing cost flow assumptions approved by the Statement of Federal Financial Accounting Standards No. 3 (first in-first out, weighted average, moving average, or any other valuation method that reasonably approximates the historical cost method); and

Management Comment. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) concurred and stated that the Department of the Navy OM&S Working Group is working to define the valuation criteria to be used for OM&S. The group is evaluating the weighted average and moving average methods of evaluation, although this decision as well as procedural and transactional level guidance must still be developed and approved by the Under Secretary of Defense, Comptroller. Estimated completion date is 31 October 2000.

4. Reviewing changes, if any, that are required to the feeder systems used to manage ammunition.

Management Comment. The Deputy Assistant Secretary of the Navy (Planning, Programming and Resources) concurred and stated that the Commanding Officer, Naval Ammunition Logistics Center, and Commander, Naval Supply Systems Command, have identified the required feeder system changes and an associated cost estimate of \$300,000.

Appendix A. Audit Process

Scope and Methodology

To fulfill our responsibilities under Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994, we performed audit work necessary to determine the status of financial reporting of conventional ammunition on the FY 1999 Navy General Fund financial statements. We examined \$10.5 billion of financial information related to Navy conventional ammunition reported on the FY 1999 financial statements as part of its OM&S. We also reviewed independent audit work performed by the Naval Audit Service, including findings and recommendations in previous audit reports. We also met with employees of the General Accounting Office and at the Naval Ammunition Logistics Center.

We did not use computer-processed data to conduct this audit. However, not using computer-processed data did not affect the results of the audit.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, the Secretary of Defense annually establishes DoD-wide corporate-level goals, subordinate performance goals, and performance measures. This report pertains to the achievement of the following goal, subordinate performance goal, and performance measures:

- **FY 2001 DoD Corporate-Level Goal 2:** Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs and reengineer the Department to achieve a 21st century infrastructure.
- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. (01-DoD-2.5)
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. (01-DoD-2.5.1)
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinion on financial statements. (01-DoD-2.5.2)

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following financial management functional area objective and goal:

-
- **Financial Management Functional Area. Objective:** Strengthen internal controls. **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act. (FM-5.3)

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the Department of Defense. This report provides coverage of the financial management high-risk area.

Audit Type, Dates, and Standards. We performed this financial-related audit from September 1999 through February 2000, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD audit community, the General Accounting Office, and the Navy. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Procedures for implementing the Directive are outlined in DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996.

Scope of Review of the Management Control Program. We did not perform a full review of the adequacy of Navy controls over accounting and reporting for OM&S because the Navy disclaimed the information and reliability of the systems and procedures used to develop the financial data reported on the financial statements.

Appendix B. Summary of Prior Coverage

General Accounting Office

Report No. 99-61 (OSD Case No. 1746), "Defense Inventory: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed," March 1999.

Report No. 98-32 (OSD Case No. 1491), "Financial Management: DoD's Liability for the Disposal of Conventional Ammunition Can Be Estimated," December 1997.

Naval Audit Service

Draft Report No. 1999-0149, "Department of the Navy Principal Statements for Fiscal Year 1999: Inventory and Related Property, Net," February 25, 2000.

Report No. 049-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Inventory and Related Property, Net," July 27, 1999.

Report No. 031-99, "Navy Program to Report Missing, Lost, Stolen, or Recovered Arms, Ammunition, and Explosives," March 26, 1999.

Report No. 028-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Reports on Internal Controls and Compliance with Laws and Regulations," February 22, 1999.

Report No. 024-99, "Department of the Navy Principal Statements for Fiscal Year 1998: Report on Auditor's Opinion," February 10, 1999.

Report No. 044-98, "Department of the Navy Principal Statements for Fiscal Years 1997 and 1996: War Reserves," September 3, 1998.

Report No. 015-98, "Department of the Navy Fiscal Year 1996 Annual Financial Report: Department of Defense Issues," December 19, 1997.

Report No. 048-97, "Department of the Navy Fiscal Year 1996 Annual Financial Report: Ammunition and Ashore Inventory," September 25, 1997.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics

Under Secretary of Defense (Comptroller)

Deputy Comptroller (Program/Budget)

Deputy Chief Financial Officer

Director for Accounting Policy

Assistant Secretary of Defense, Command, Control, Communications and Intelligence

Director, Defense Logistics Studies Information Exchange

Department of the Army

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Assistant Secretary of the Navy (Financial Management and Comptroller)

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Commander, Naval Ammunition Logistics Center, Naval Supply Systems Command

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House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International
Relations, Committee on Government Reform

Department of the Navy Comments



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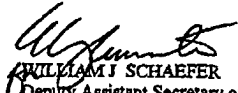
MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT
INSPECTOR GENERAL FOR AUDITING

Subj: DODIG DRAFT REPORT ON NAVY FY 1999 FINANCIAL REPORTING OF
OPERATING MATERIALS AND SUPPLIES - AMMUNITION (PROJECT NO.
D2000FF-0069.002)

Ref: (a) DODIG Memo of 30 May 00

Encl: (1) Department of the Navy Response

In response to reference (a), our comments are provided in Enclosure (1). We concur with the recommendations


WILLIAM J. SCHAEFER
Deputy Assistant Secretary of
the Navy
Planning, Programming and
Resources

Copy to:
NAVJNSGEN (42)
NAVSUP (91E)
ASN (FM&C)

Department of the Navy Comments

DEPARTMENT OF THE NAVY COMMENTS ON
DODIG DRAFT AUDIT REPORT,
"DEPARTMENT OF THE NAVY FY 1999 FINANCIAL REPORTING OF
OPERATING MATERIALS AND SUPPLIES - AMMUNITION"
(PROJECT NO. D2000FJ-0069.002)

FINDING:

The Navy was unable to implement all elements of Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property, Net," October 27, 1993, because of the limitations of its financial management processes and systems, including nonfinancial feeder systems. The Navy reported an ammunition balance of \$10.5 billion, but disclaimed the appropriateness of that balance. Navy managers stated that they had been making process and systems improvements and addressing the limitations of the Navy's financial and nonfinancial feeder systems. However, the system limitations were significant reporting issues that remained unresolved for the FY 1999 financial statements. The Navy was waiting for a new DoD ammunition accounting system to correct deficiencies, but the continued development of the new system is currently in question and may not be fielded in FY 2001. As a result, the balance reported for ammunition in the Operating Materials and Supplies account of the FY 1999 Navy General Fund Balance Sheet could not be confirmed and will not be for several years.

DEPARTMENT OF THE NAVY COMMENT

Concur. The Conventional Ammunition Integrated Management System (CAIMS) does not meet all the requirements of the SFFAS No. 3, particularly regarding valuation at historical cost. Conflicts in policy and guidance in the DoD Financial Management Regulation (DoD 7000.14-R) and the DoD Material Management Regulation (DoD 4140.1-R) for the valuation of ammunition precludes the Naval Ammunition Logistics Center (NALC) from incorporating system changes into CAIMS to meet the requirements of the SFFAS No. 3. By Assistant Secretary of the Navy (Financial Management & Comptroller) memorandum of 12 July 2000, the Under Secretary of Defense (Comptroller) (USD(C)) was requested to provide specific resolution to the conflicting policy and guidance in the DoD regulations. A copy of the memorandum is attached. To remain proactive, NALC has begun the analysis and cost benefit identification of making CAIMS compliant with federal accounting standards. Evaluation is currently underway to draft the appropriate business rules for meeting the cost flow assumptions of the SFFAS No. 3. Costs to achieve CFO compliance have been estimated at \$300,000.00.

ADDITIONAL COMMENTS:

Recommend the last two sentences of paragraph 3 under "Navy Ammunition System and CFO Act" on page 5 of your report is replaced with the following: "The initial change to

an Open System Environment (OSE) will be completed by October 2000. Additional changes to provide greater functionality and capabilities will be completed by December 2002. The Navy spent \$2.2 million between FY 1997 and FY 1999 to upgrade CAIMS and plans to spend an additional \$640,000 during FY 2000."

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend the Commanding Officer, NALC and Commander, NAVSUP, determine the costs and benefits of making system design changes to CAIMS to properly value Navy ammunition at historical cost. The Navy should determine the practicality of system design changes by:

1. Reviewing short-term benefits to be gained while awaiting the possible development of the Joint Ammunition Management Standard System (JAMSS) and long-term benefits if JAMSS is not fielded;

DEPARTMENT OF THE NAVY COMMENT

Concur. The development and deployment of JAMSS would eliminate the need to bring CAIMS into compliance as a financial feeder system; however, the existing deployment timeline is unacceptable for achieving a clean opinion on the Department of the Navy's financial statements. Benefit analysis of correcting CAIMS versus awaiting the deployment of JAMSS has been completed, with the decision made to implement system changes to CAIMS after clarification of the policy conflict between the DoD Financial Management Regulation and the DoD Material Management Regulation. Action considered complete.

RECOMMENDATION

2. Reviewing costs to be incurred;

DEPARTMENT OF THE NAVY COMMENT

Concur. The cost of a third-party evaluation of CAIMS as required by current Department of the Navy guidelines is estimated at \$250,000.00. The Statement of Work is currently being developed to accomplish this third-party evaluation. An internal analysis of CAIMS established a total cost of \$300,000.00 to make CAIMS compliant. Action considered complete.

RECOMMENDATION

3. Reviewing cost flow assumptions approved by the Statement of Federal Financial Accounting Standards No. 3 (first-in, first-out, weighted average, moving average, or any other valuation method that reasonably approximates the historical cost method); and

DEPARTMENT OF THE NAVY COMMENT

Concur. The DON Operating Materials and Supplies Working Group which includes representatives from the General Accounting Office, the DoD Inspector General, the Naval Audit Service, and DON offices, has been working to define the valuation criteria to be used for operating materials and supplies. This group is also working with the Accounting Policy staff from USD(C). Additionally, the group is evaluating the weighted average and moving average methods of evaluation, although this decision as well as procedural and transactional level guidance must still be developed and approved by USD(C). Resolution of the conflicting regulations mentioned above will remove one impediment to the valuation decision. Estimate completion date is 31 October 2000.

RECOMMENDATION

4. Reviewing changes, if any, that are required to the feeder systems used to manage ammunition.

DEPARTMENT OF THE NAVY COMMENT

Concur. We have identified the system changes and an associated cost estimate of \$300,000.00. Valuation policy conflicts must be resolved prior to actual accomplishment of the system changes identified. Action considered complete.

Audit Team Members

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